

**REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL
LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND
PERFORMANCE INFORMATION OF EDUMBE MUNICIPALITY FOR THE YEAR ENDED
30 JUNE 2008**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Edumbe Municipality which comprise the statement of financial position as at 30 June 2008, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages xx to xx.

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
4. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the Edumbe municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.

Basis of accounting

5. The municipality's policy is to prepare financial statements on basis of accounting determined by the National Treasury, as set out in accounting policy note 1.

Basis for disclaimer of opinion

Operating expenditure

6. The occurrence, completeness and accuracy of general expenditure transactions totalling R4,001 million could not be confirmed as a result of insufficient supporting documentation. In this regard, the municipality's records did not permit the application of alternative audit procedures and explanations considered necessary, could not be obtained.
7. Electronic Fund Transfer payments to the value of R508 454 were not processed in the accounting records, resulting in an understatement of electricity purchases and an overstatement of cash and cash equivalents by the same amount. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the completeness and accuracy of electricity purchases.

Payables

8. The valuation of payables is stated at R15,464 million in note 4 to the financial statements. This balance included unsupported suspense accounts of R3,776 million and other payables of R782 562 as well as incorrectly classified and unsupported indigent debtor balances of R7,782 million. Moreover, an unexplained difference of R1,435 million existed between the trade payables balance of R1,507 million and the payables sub-listing of R71 730. The entity's records did not permit the application of alternative audit procedures regarding payables. Consequently, I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the existence, completeness, obligations and valuation of payables.
9. Transactions totalling R519 250 were not accrued for at year-end, resulting in an understatement of the payables and operating expenditure.

Receivables

10. I was unable to confirm or verify by alternative auditing procedures the valuation, completeness and existence of other debtors totalling R4,385 million included in note 11 to the financial statements. In this regard, the above balance included suspense accounts of R2,440 million as well other debtors of R1,945 million, for which no supporting records, reconciliations and explanations were provided.
11. An assessment of the recoverability of consumer debtors revealed a history of non-payment. Consequently, the provision for the write-down of consumer debtors of R3,55 million, as disclosed in note 10 to the financial statements, is deemed to be understated and receivables overstated by R20 million, respectively.

Revenue

12. I did not obtain all the information and explanations I considered necessary to satisfy myself as to the completeness, occurrence and accuracy of an amount of R588 280, relating to licence fees that are included as "Other services/levies" in the statement of financial performance. The entity's records did not permit the application of alternative audit procedures, as no explanations and documentation could be provided.

Cash and cash equivalents

13. The cash and cash equivalents balance of R1,573 million, included "stale cheques" to the amount of R1,570 million, which had not been written back into the accounting

records. Consequently, cash and cash equivalents is understated by R1,570 million, and employee related costs are understated by R1,570 million, respectively.

14. Payments totalling R6,804 million were not recorded in the cashbook on a monthly basis. Consequently, numerous unmatched transactions existed at year-end, which were not appropriately allocated, thus I could not obtain sufficient appropriate evidence about the completeness, occurrence and accuracy of the cash and cash equivalents balance and the related general expenditure.
15. Cancelled cheques amounting to R79 821 were incorrectly reflected as outstanding cheques in the bank reconciliation, which impacted on the completeness and accuracy of the cash and cash equivalents balance and related general expenditure.
16. Employee related costs amounting to R2,395 million were not reconciled to the cashbook and were incorrectly reflected as outstanding cheques on the bank reconciliation. This impacted on the completeness and accuracy of the cash and cash equivalents balance as well as employee related costs.
17. Outstanding deposits reflected in the accounting records totalling R129 277 were not recorded in the bank reconciliation as reconciling items, thus I could not obtain sufficient appropriate audit evidence about the accuracy and completeness of the cash and cash equivalents balance as well as revenue from service charges.

Cash flow statement

18. The net movement in cash and cash equivalents of R1,764 million (credit) did not agree to the cash flows from operating, financing and investing activities of R5,956 million (debit) in respect of the 2006-07 comparative cash flow statement figures. In this regard, alternative audit procedures could not be performed, as management was unable to provide information and explanations considered necessary for the difference of R4,192 million.

Corresponding figures

19. Corresponding figures were not included for all financial statement amounts, namely remuneration for councillors (2006-07: R1,865 million), commitments and the provision for rehabilitation of a landfill site. I was unable to quantify the misstatement for commitments and the provision for rehabilitation of the landfill site and perform alternative audit procedures, as explanations and information were not provided in this regard.

Employee benefits

20. The completeness, accuracy, occurrence, existence and valuation of the leave pay provision totalling R791 101, as disclosed in note 16 to the financial statements, as well as employee related costs could not be confirmed due to limitations placed on the scope of my work by the entity. In this regard, alternative procedures were not feasible because leave registers were not up to date and records supporting the balance could not be provided.

Fruitless and wasteful expenditure

21. The municipality did not timeously submit Value-Added-Taxation (VAT) returns to the South African Revenue Services (SARS) in terms of section 28(1) of the VAT Act, 1991 (Act No. 89 of 1991). Consequently interest and penalties totalling R466 015 were imposed by SARS in terms of section 39 of the VAT Act. This had not been disclosed as fruitless and wasteful expenditure, as required by section 125(2)(d) of the MFMA.

Intangible assets

22. The annual costs of software licences (R84 500) as well as operating system software expenses (R27 227) were incorrectly capitalised to intangible assets. Consequently additions to intangible assets and operating expenses were over and understated, respectively. Had the error been corrected, accumulated surpluses and intangible assets would have been reduced by an amount of R111 727.

Commitments

23. Note 22 to the financial statements records an amount of R8,830 million in respect of capital commitments, which could not be confirmed for completeness, occurrence, existence, obligations and valuation. In this regard, alternative audit procedures could not be performed as the necessary information, explanations and records could not be provided in support thereof.

Disclaimer of opinion

24. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the Edumbe Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

I draw attention to the following matter:

Restatement of corresponding figures

25. As disclosed in note 26 to the financial statements, the corresponding figures for 30 June 2007 have been restated as result of an error discovered during the year under review in the financial statements of the Edumbe Municipality, at and for the year ended 30 June 2007.

OTHER MATTERS

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Internal controls

26. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Operating expenditure			✓		✓
Payables			✓		✓
Receivables			✓		✓

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Revenue		✓	✓		✓
Cash and cash equivalents		✓	✓	✓	✓
Cash flow statement			✓		✓
Corresponding figures			✓		
Employee benefits			✓	✓	✓
Fruitless and wasteful expenditure	✓		✓		✓
Intangible assets			✓		✓
Commitments			✓		✓

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.

Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

Non-compliance with applicable legislation

Municipal Finance Management Act

27. Risk assessments were not conducted and a fraud prevention plan was not finalised, as required by section 62(1)(c).
28. Bank accounts were not reconciled on a monthly basis, as required by section 62(2).
29. Policies and procedures were not developed for major accounting cycles, as required by sections 64(2) and 65(2).
30. The municipality's website was not updated with the required information, as required by section 75.
31. The municipality did not submit and table its 2006-07 annual report, as required by section 127.

Municipal Systems Act

32. A credit control and debt collection policy was not implemented, as required by section 96(b) of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000).

Division of Revenue Act

33. Signed returns on conditional grant spending has not been submitted to the relevant treasury in terms of sections 12(1)(b) and 12(4) of DoRA and section 71(5) of the MFMA.

Matters of governance

34. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matters of governance	Yes	No
Audit committee		
• The municipality had an audit committee in operation throughout the financial year.		✓
• The audit committee operates in accordance with approved, written terms of reference.	✓	
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		✓
Internal audit		
• The municipality had an internal audit function in operation throughout the financial year.	✓	
• The internal audit function operates in terms of an approved internal audit plan.	✓	
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		✓
Other matters of governance		
• The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.	✓	
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		✓
• The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		✓
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		✓
• The prior year's external audit recommendations have been substantially implemented.		✓
Implementation of Standards of Generally Recognised Accounting Practice (GRAP)		
• The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.		✓
• The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.		✓
• The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.		✓

Unaudited supplementary schedules

35. The municipality provided supplementary information in the financial statements on whether resources were obtained and used in accordance with the legally adopted budget, in accordance with GRAP 1 *Presentation of Financial Statements*. The supplementary budget information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. Accordingly I do not express an opinion thereon.
36. The supplementary information set out on pages xx to xx do not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

37. I was engaged to review the performance information.

Responsibility of the accounting officer for the performance information

38. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000)(MSA).

Responsibility of the Auditor-General

39. I conducted my engagement in accordance with section 13 of the PAA read with General Notice 616 of 2008, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
40. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
41. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

Existence and functioning of a performance audit committee

42. The Edumbe Municipality did not appoint and budget for a performance audit committee. Moreover, neither was another audit committee utilised as a performance audit committee, as required by section 14(2)(a) of Local Government Performance Management Regulations, which was issued in *General Notice 715*, as published in *Government Gazette No. 28895 dated 31 May 2006*.

Internal auditing of performance measurements

43. The Edumbe Municipality did not develop and implement mechanisms, systems, and processes for auditing the results of performance measurement as part of its internal audit processes, as required in term of section 45 of the MSA.

Performance information not received in time

44. The financial statements submitted for auditing did not include a report on the performance information of the municipality, as required by *General Notice 616* as published in *Government Gazette No. 31057 dated 15 May 2008*; read with section 46 of the MSA and was still not received at the date of this report.

APPRECIATION

45. The assistance rendered by the staff of the Edumbe Municipality during the audit is sincerely appreciated.

Pietermaritzburg

28 November 2008

